



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Nelson Mandela Bay Metropolitan Municipality

Audit Report

For the year ended 30 June 2013

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE NELSON MANDELA BAY METROPOLITAN
MUNICIPALITY**

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality and its subsidiary set out on pages XX to XX, which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statement of financial performance, statement of changes in net assets and the statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2001) (PAA), the general notice issued in terms thereof and International Standards on Auditing (ISAs). Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 44 and 44.2 to the consolidated and separate financial statements is understated in respect of amounts of R935,4 million (2012: R554 million) incurred during the year which were identified during the audit process, while the opening balance for 2011-12 is also understated by R710 million in this regard. Due to the lack of systems and non-availability of sufficient appropriate audit evidence for all awards, I was unable to determine the full extent of the understatement of irregular expenditure included in the unauthorised, irregular and fruitless and wasteful expenditure balance of R869,7 million (2012: R716,5 million) in note 44. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Qualified opinion

7. In my opinion, except for the effects and possible effects of the matters described in the basis for qualified opinion paragraph, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of comparative figures

9. As disclosed in notes 40 to the consolidated and separate financial statements, the comparative figures for 30 June 2012 have been restated as a result of a change in accounting policy and errors that were only corrected during the financial year ended 30 June 2013 but that existed in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2012.

Unauthorised, irregular and fruitless and wasteful expenditure

10. As disclosed in note 44 to the consolidated and separate financial statements, R471,6 million of unauthorised, irregular and fruitless and wasteful expenditure was incurred during the financial year. This includes unauthorised expenditure amounting to R270,7 million which was incurred due to overspending in respect of a number of votes within the approved municipal expenditure budget.

Material losses and impairments

11. As disclosed in note 28 to the consolidated and separate financial statements, the impairment of receivables amounted to R409,8 million for the year.

12. As disclosed in note 35.9 to the consolidated and separate financial statements, water losses amounting to R208,4 million were incurred during the financial year.

Material underspending of the capital budget

13. As disclosed in note 54 to the consolidated and separate financial statements, the municipality underspent on its roads and storm water infrastructure budget by R184,5 million.

Additional matter

14. I draw attention to the matter below. My opinion is not modified in respect of this matter

Unaudited supplementary

15. The supplementary information set out in appendix C does not form part of the consolidated and separate financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following matters relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of the annual report.

18. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMSSI).

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

19. There were no material findings on the annual performance report concerning the usefulness and reliability of the information.

Additional matter

20. Although no material findings concerning the usefulness and reliability of the performance information were raised in the annual performance report, I draw attention to the matter below.

Achievement of planned targets

21. Of the total number of 112 targets planned for the year, 50 were not achieved. This represents 45% of total planned targets that were not achieved during the year under review.

22. The reasons for this under-achievement were the poor implementation and monitoring of the budget and a lack of actions taken during the year to correct the under-achievement.

Compliance with laws and regulations

23. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance

24. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Annual financial statements

25. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.

26. Material misstatements of revenue and expenditure identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

27. Reasonable steps were not taken to prevent unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

28. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.

29. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Conditional grants

30. The municipality did not submit quarterly performance reports to the transferring national officer, the Eastern Cape Provincial Treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.

31. The municipality did not submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of DoRA.

Consequence management

32. Allegations of financial misconduct against senior managers were not always tabled before council, as required by *Local government: Disciplinary regulations for senior managers* regulation 5(2).

33. The council did not appoint an independent investigator to investigate all allegations where there was reasonable cause to believe an act of misconduct had been committed, as required by *Local government: Disciplinary regulations for senior managers* regulation 5(3)(a).

Human resource management

34. An acting chief financial officer was appointed for a period of more than six months, in contravention of section 56(1)(c) of the Municipal Systems Act.

Procurement and contract management

35. Sufficient appropriate audit evidence could not be obtained that:

- bid specifications were drafted by bid specification committees which consisted of one or more officials of the municipality, as required by supply chain management (SCM) regulation 27(3);
- invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2);

- bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM Regulation 28(2);
- contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a) and the Preferential procurement regulations;
- bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2);
- awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b);
- councillors of the municipality participated in committees evaluating or approving tenders/quotations, in contravention of section 117 of the MFMA;
- contracts were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations;
- contracts were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act;
- contracts were extended or modified only after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA;
- all extensions or modifications of contracts were approved by a properly delegated official, as required by SCM regulation 5;
- the performance of contractors or service providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA;
- the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA;
- contracts were awarded only to service providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43;
- contracts were awarded only to bidders who had submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c);
- measures to combat the abuse of the SCM system were implemented as per the requirements of SCM regulation 38(1), because it could not be determined whether awards had been made to service providers who:
 - during the last five years, failed to perform satisfactorily on a previous contract with the municipality or municipal entity or other organ of state;
 - committed a corrupt or fraudulent act in competing for the contract;
 - abused the SCM system of the municipality.

36. Awards were made to service providers who were in the service of the municipality and/or whose directors/ principal shareholders were in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore the service provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality had not taken disciplinary action against the suppliers/officials involved;

37. Awards were made to service providers who were in the service of other state institutions, in contravention of section 112(i) of the MFMA and SCM regulation 44. Similar awards had been identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

38. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

39. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

Internal control

40. I considered internal control relevant to my audit of the consolidated and separate financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion and the findings on compliance with laws and regulations included in this report.

Leadership

41. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls. Failure to instil basic disciplines and provide a strong leadership tone to ensure sound financial management and compliance with laws and regulations has resulted in inaccurate and incomplete financial reporting as well as the contravention of laws and regulations.

42. There was a lack of permanent and committed leadership within the municipality which, together with the political and administrative instability, filtered through to the key functional areas of the institution. More than 80% of senior management positions were vacant during the year, 45% of which for a period longer than 12 months. The continued absence of permanent senior officials to lead and guide the municipality compromises sound financial management and accountability.

43. A clear pattern of the political and administrative leadership's slow response to the audit messages and root causes is evident by the repeat findings in respect of irregular expenditure and non-compliance with laws and regulations.

Financial and performance management

44. The municipality did not consistently implement and monitor the required daily and monthly financial disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial reporting framework. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end, which led to numerous material adjustments having to be made to the financial statements during the audit process.

45. Management did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation. In addition, awareness of SCM requirements among officials across all functional areas was not at the required level, as evidenced by the amount of irregular expenditure identified during the audit. There was inadequate documentation and records management to ensure that sufficient, appropriate audit evidence existed in the area of SCM.

Governance

46. A risk assessment was conducted by the municipality and a risk strategy, which included a fraud prevention plan, was prepared. The risks identified by management were, however, not adequately matched with the appropriate internal controls of the municipality, which contributed to the internal control deficiencies identified during the audit.

47. The recommendations made by internal audit and the audit committee were not adequately responded to, as improvements in the control environment did not resolve all control deficiencies identified. Consequently, recurring material non-compliance and misstatements in the financial statements have been reported.

OTHER REPORTS

Investigations

48. At the time of this report, 20 investigations were being conducted relating to allegations of fraud, corruption and failure to comply with SCM requirements.

Juditor-General
East London

6 December 2013



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